Section 2

Appellate Conference Opportunities

Hypothetical #2 Innocent Spouse

Sample Brief for the Petitioner:
"Ms. Informed vs. the Commissioner of Internal Revenue"

Hypothetical #2

INNOCENT SPOUSE

Chad has led an exciting life. He successfully practiced tax law simultaneously in New York and Texas maintaining two different offices. To go along with his different offices, Chad has also been able to juggle two families at the same time without either knowing about the other. Chad's New York wife, Ellen is a tax professor at NYU and teaches the course on corporate tax shelters. Mary Sue, Chad's Texas wife, has been content to be a housewife and raise their four children.

As a result of a civil tax examination, the government has determined that Chad failed to report $3 million from his New York practice and an additional $2 million from his Texas practice. In addition, Chad has unsuccessfully invested in a tax shelter which will result in a deficiency of approximately $3 million. Chad filed a joint return with his New York wife reporting all of the New York legal income and using one-half of the tax shelter on that return. Chad filed a joint return with his Texas spouse reporting all of his Texas income and using one-half of the tax shelter on that return. Mary Sue knew that Chad practiced in New York but had no idea that he was married there and did not know that Chad used approximately $300,000 from his New York income to help build their Texas house.

Chad, in an effort to save his marriages, had successfully hidden the Internal Revenue Service investigation from both spouses. However, the New York spouse learned of the investigation shortly after receiving a deficiency notice addressed to both of them in New York. Mary Sue, unfortunately, did not learn of the result of the audit until she was cleaning up the house and noticed an envelope from the Internal Revenue Service tucked away in the corner. Unfortunately, the envelope was postmarked more than 120 days ago.

The Service has imposed the fraud penalty and the substantially understatement penalty. The government is also considering criminal charges against Chad.

MS. INFORMED,	)	
	)	
Petitioner,	)	
	)	
v.	)	DOCKET NO. 1234-03
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
	)	
Respondent.	)	
_____	)	

OPENING BRIEF FOR PETITIONER

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STATEMENT OF THE CASE

The apparent disputed issue in this case is whether Respondent abused his discretion when relief, both in whole and in part, was denied for the balance remaining due on Petitioner's 1995 income tax return which she filed jointly with Mr. Unreliable, her husband for less than four months of that year. Respondent would have this court confine its analysis under the standard of review to what Respondent contends is Respondent's "administrative record." It is not Petitioner's position that Respondent's administrative files should be ignored by the court in applying the standard of review. Rather, it is Petitioner's position that Respondent's administrative file cannot stand alone as the sole source of uncontroverted evidence for this court's analysis of Respondent's conduct.

Irrespective of any determination this court may make regarding the admissibility and utilization of Respondent's proffered "administrative record" in this case, it is clear from the record created during trial through stipulations, exhibits, testimony and the administrative files labeled Exhibit 10-R, that Respondent failed to consider all the facts and circumstances surrounding Petitioner's case and in so doing, abused his discretion by denying either total or partial relief to Petitioner for the 1995 income tax liability.

Petitioner raised a third issue at trial regarding the validity and utility of Revenue Procedure 2000-15 in light of Respondent's 2002-2003 business plan stating an intention to update the guidance. Petitioner understands that the court is

loathe to substitute its judgment for the Commissioner's in performing its analysis as to whether discretion has been abused. However, Petitioner believes that the very promulgation of Rev. Proc. 2000-15 was an abuse of the discretion granted to the Commissioner under the statutory language and legislative intention of section 6015(f).

Trial was before the Honorable Totally Impartial on March 1, 2003 in Everytown, California. Simultaneous opening briefs are due May 29, 2003.

QUESTIONS PRESENTED

1. Is this court confined to what Respondent identifies as the administrative file when considering whether Respondent's determination to deny relief to Petitioner was an abuse of discretion?

2. Did the Commissioner abuse his discretion when he denied both full and partial relief to Petitioner pursuant to IRC section 6015(f) for the tax balance shown due on, but not paid with, the 1995 joint income tax return filed by Petitioner and her husband of less than four months?

3. Is Petitioner entitled to relief from the 1995 income tax liability, either in whole or in part?

PROPOSED FINDINGS OF FACT

Petitioner has a college degree and is licensed as a clinical laboratory scientist. She took no accounting or business courses as part of her educational training. Transcript of Proceedings ("Trans.") p. 112, l.22- 113, l.12.

Petitioner married Mr. Unreliable on September 9, 1995. Stip. ¶1.

The marriage was the first for Petitioner and the second for Mr. Unreliable. Trans. p. 38, ls.23-25; p. 113, ls.16-19.

Mr. Unreliable had unpaid income tax liabilities for the years 1993 and 1994 which he did not disclose to Petitioner at the time they married. Trans. p. 42, ls. 8-21.

Petitioner and Mr. Unreliable kept their finances separate and did not co-mingle their income either before or during their marriage. Trans. p. 41, ls. 3-25; p. 44, ls. 15-24; p. 114, ls.11-21; p. 115, ls. 10-25; p. 116, ls. 20-25; p. 117, l. 7-118, l.3.

Prior to the marriage, Petitioner understood that Mr. Unreliable had a financial services business but did not know how much he earned. Trans. p. 116, ls.20-25.

Mr. Unreliable had the couple's joint income return for 1995 prepared by a preparer he had used in previous years for tax return preparation. Petitioner gave her tax information to Mr. Unreliable to take to the preparer and never spoke to or met the preparer. Trans. p. 51, l. 23- 52, l. 23.

Mr. Unreliable also had his preparer prepare separate tax returns for himself and Petitioner for the 1995 year. Trans. p.

52, ls. 8-19; p. 121, ls. 15-22.

Petitioner's married filing separate return reflected a refund due attributable to her W-2 withholding. Trans. p. 123, ls. 9-12.

Mr. Unreliable's married filing separate return reflected a liability in excess of that reflected on the joint return. Trans. p. 123, ls. 14-18.

The joint tax return prepared for 1995 showed Petitioner had W-2 wages of $40,250.00, federal income tax withheld of $10,862.33 and state income tax/SDI withheld of $3,675.26. Mr. Unreliable's schedule C included with the return showed gross receipts of $50,750.00 and net self-employment income of $23,502.00. No credits for estimated tax payments are reflected on the return. A total of $200 in interest income was also reported on the joint return. Exhibit 1-J.

The joint tax return prepared for 1995, as hand corrected by Mr. Unreliable, reflected total tax of $16,892.00, $3,321.00 of which was attributable to Mr. Unreliable's self-employment tax. Exhibit 1-J.

Of the total income tax liability of $13,571.00 reflected on the joint return for 1995, Petitioner's withholding of $10,862.00 covered 80%.

Petitioner was upset and surprised that the 1995 joint return showed a substantial liability because she had never owed tax with a return before. Trans. p. 122, ls. 6-15.

Petitioner agreed to file a joint 1995 tax return with Mr. Unreliable, even though filing separately would have resulted in

a refund for Petitioner, because the joint return resulted in less tax due for Mr. Unreliable. Exhibit 7-J; Trans. p. 123, ls. 2-18.

Before she signed the 1995 tax return showing a balance due greater than the amount paid with the return, Petitioner confirmed with Mr. Unreliable that he was responsible for the liability and that he was going to pay the remaining balance due in installments. Trans. p. 56, ls. 2-14; p. 58, l. 20- p. 59, l. 25; p. 64, ls. 18-24; p. 90, ls. 15-21; p. 123, l. 20- p. 125, l. 4; Exhibit 8-P.

On April 15, 1996, Petitioner filed the joint income tax return with Mr. Unreliable for the year 1995 showing a balance due of $6,220.00. The income tax portion of the liability was $6,030.00. An estimated tax penalty of $190.00 was also reflected on the return. Stip. ¶'s 2, 3, 4; Exhibit 1-J.

Payments in the total amount of $1,620.00 were made with the 1995 joint tax return when filed. Of the total paid with the return, Petitioner paid $1,069.00. Stip. ¶'s 5,7.

Petitioner's withholding credit and payment with the tax return totaled $11,931.00, or nearly 88% of the total income tax liability due for 1995. Petitioner's taxable earnings for the year were only 69% of the couple's combined earnings for the year. Exhibit 1-J.

Petitioner believed that Mr. Unreliable was going to mail the form he had showed her, requesting installment payments, with their joint tax return, and that he was going to make payments on the balance due as he had indicated on the form. Trans. p. 124,

l.24- 125, l.4.

Mr. Unreliable took responsibility for mailing the 1995 tax return and the accompanying payments as well as the installment agreement request form. Trans. p. 59, l. 23 - p. 60, l. 10.

Prior to 1995, Petitioner had been a W-2 wage earner and filed short forms of the 1040 since she was sixteen years old. She believed that a tax return showing a balance due could not be filed if arrangements were not being made at the same time to make payments on the liability. Trans. p. 122, ls. 12-14; p. 124, ls. 2-20; p. 148, ls. 1-9.

From April 15, 1996 until November, 1998, Petitioner believed that Mr. Unreliable had been paying the remaining 1995 income tax liability pursuant to the installment agreement form he told her he was filing with the return. Trans. p. 126, ls.15-21.

In April, 1996, when she signed the 1995 joint income tax return, Petitioner did not have a permanent, full-time job and did not have sufficient funds in her bank account to pay the entire liability without jeopardizing her ability to provide basic living expenses. Trans. p. 118, ls. 7-22; p. 125, l. 18-126, l. 8; p. 156, ls. 19-24; p. 170, l. 14- 171, l.2.

During the entire year 1996, Petitioner maintained a notebook in which she accounted for the joint household expenses she paid. Periodically during the year, Petitioner advised Mr. Unreliable how much his share of the household expenses were, and he reimbursed Petitioner in the amount she told him. Trans. p.

120, ls. 8-15.

Mr. Unreliable's schedule C for the year 1996 as reflected on the tax return filed for that year reflects net business income of $1,703.00. Trans. p. 48, l. 9- 49, l. 4.

Mr. Unreliable's schedule C for the year 1997 as reflected on the tax return filed for that year reflects net business income of $7,597.00. Trans. p. 69, ls. 6-19.

After Mr. Unreliable lost his S.E.C. license in 1997, Petitioner became the primary earner in the family. By 1998, Petitioner was paying substantially all the household expenses using her wage income. The household expenses of which Petitioner paid at least 80% for 1997 and 1998, including rent, utilities, transportation, and medical insurance, averaged approximately $2,800.00 per month. In addition, Petitioner paid for groceries and her own personal and work-related expenses. Petitioner paid the entire 1997 income tax liability of $4,453.00 in April, 1998. Trans. p. 119, l. 3- 120, l. 7; p. 129, l. 13- 131, l. 3; p. 132, l. 19- 133, l. 20; p. 134, ls. 3-25.

Between 1997 and 2000, Mr. Unreliable was employed on a commission only basis selling insurance. Trans. p. 68, ls. 4-19.

Between 1997 and 2001, Mr. Unreliable had medical problems involving his hips which resulted in two major surgeries and kept him from working for extended periods of time during which Petitioner supported herself, Mr. Unreliable and their household. Trans. p. 131, l.4- 132, l. 11; p. 168, l.11- 169, l.5.

In early 1999, Mr. Unreliable submitted two offers in compromise through his representative, Barely Able- one for the

years 1993 and 1994, and one for the year 1995. Both offers were based on Mr. Unreliable's inability to pay the entire liability. Trans. p. 79, l. 25- 80, l. 12.; p. 81, ls. 3-7.

There are no unpaid tax liabilities due from Petitioner for the tax years 1998 or 1999. Stip. ¶10.

Petitioner and Mr. Unreliable are still married and have lived together continuously since September 9, 1995. Stip. ¶12.

Petitioner did not discover that Mr. Unreliable had not paid the balance of the 1995 tax return as he had promised until November, 1998 when a notice of tax due for that year was received from Respondent. Trans. p. 75, ls. 5-19.

When the notice of tax due for 1995 came to Petitioner's residence in November, 1998, Mr. Unreliable mislead Petitioner by telling her, for the first time, that he had pre-marital tax liabilities for 1993 and 1994 and that the notice was for those. He kept the letter from her and did not admit the notice was for 1995 until she questioned him further. Trans. p. 126, ls.14-20.

Mr. Unreliable lost his S.E.C. license in 1997 but has never disclosed to Petitioner any details of the events or investigation leading up to the suspension. Trans. p. 126, l. 21-127, l. 9.

On January 26, 1999, a Form 8857, Request for Innocent Spouse Relief, was submitted on behalf of Petitioner which requested equitable relief from the balance remaining due for the 1995 tax year. Exhibit 7-J; Stip. ¶15.

Petitioner's Request for Relief was prepared and submitted by Barely Able in consultation with Mr. Unreliable. Petitioner

met Mr. Kiffe only once. All communication regarding the submission was between Mr. Unreliable and Barely Able. Trans. p. 76, ls. 7-21; p. 79, ls. 7-17; p. 100, l. 24- 101, l. 3; p. 137, l. 5- 138, l. 10.

In an Exhibit A attached to the Form 8857, Petitioner stated that she had not learned that the balance remaining due for 1995 was not paid until November, 1998; that when she signed the return Mr. Unreliable lead her to believe that he would pay the balance because it was attributable to his self-employment income and failure to make estimated tax payments; that there is no community income or assets because she and Mr. Unreliable have always maintained separate property and bank accounts; and, that the withholding on her W-2 wages, even without the additional payment she made with the return on April 15, 1996, was sufficient to pay the tax liability on the 1995 return attributable to Petitioner's items. Exhibit 7-J; Stip. ¶15.

A second representative who replaced Barely Able when he stopped doing business, never met or talked with Petitioner regarding the Request for relief. Trans. p. 81, ls. 12-25.

Neither Barely Able or his successor ever asked Petitioner for her personal financial information. However, Barely Able received financial information from Mr. Unreliable for use in preparing the offer in compromise, and had copies of the joint tax returns Petitioner filed with Mr. Unreliable. Trans. p. 163, l. 20- 164, l. 5.

On August 23, 1999 a Final Determination was issued by the Respondent to Petitioner denying relief because: "You did not

meet the requirements for equitable relief." There were no explanatory attachments to this Final Determination letter. The August 23, 1999 letter advised Petitioner to contact "the person whose name and telephone number are shown above..." with questions. However, no name or telephone number were included in the spaces provided on the letter. Exhibit 12-J.

On October 31, 2000, Respondent issued a Notice of Determination Concerning Relief from Joint and Several Liability Under Internal Revenue Code Section 6015 denying Petitioner's request for equitable relief. The notice was incorrectly addressed to Petitioner at a business address used by Mr. Unreliable. Exhibit 6-J; Stip.¶14; Trans. p. 142, ls.5-13, l.23- p. 143, l.12.

In his Notice of Determination, Respondent determined that Petitioner was not entitled to relief under §6015(b), (c) or (f) because: "You had knowledge of the liability, and you are still married and living with the nonrequesting spouse." Exhibit 6-J.

When her request for relief was being considered by Appeals, Petitioner signed a statement dated December 8, 1999 which she believed was requested by the Appeals Officer. The letter stated: "I hereby state to you and for the record that I possessed a bona fide reasonable belief that my spouse of three months, Mr. Unreliable, was going to pay his tax obligation for the 1995 tax year. Under penalties of perjury, and to the best of my belief I hereby declare that the above statement is true." The letter was provided to the appeals officer by Barely Able. Exhibit 9-P; Stip. ¶20; Trans. p. 138, l. 15- p. 139, l. 25.

Petitioner has never received any funds from Mr. Unreliable, other than amounts he gave her to reimburse for her advances of household expenses. Trans. p. 135, ls. 12-15.

Since 2000, Petitioner has filed separate income tax returns using the married filing separate status. Trans. p. 168, ls. 1-10.

PROPOSED FINDINGS OF ULTIMATE FACTS

4. On April 15, 1996 when Petitioner executed the 1995 joint income tax return, she reasonably believed that Mr. Unreliable was going to pay the balance remaining due on the return by making installment payments. Proposed Findings ¶'s 5, 16, 17, 18, 20, 21, 22, 45.

5. The total of $11,931.00 which Petitioner paid through withholding and with the 1995 joint income tax return was more than sufficient to pay any tax liability attributable to her items on the return. Proposed Findings ¶'s 11, 13, 17, 18, 19.

6. Any balance currently remaining due on the 1995 tax return is attributable to items of Mr. Unreliable. Proposed Findings ¶'s 10, 11, 12, 13, 15, 16, 19.

7. Respondent abused his discretion by denying either full or partial relief to Petitioner based on the reasons stated in the Notice of Determination dated October 31, 2000. *Passim.*

8. Pursuant to the equitable provisions of section 6015(f), Petitioner is entitled to be relieved of liability for any balance remaining due for the 1995 tax year and, to the extent applicable statutes allow, is entitled to a refund for amounts paid in excess of any tax liability attributable to her items on the 1995 tax return.

ARGUMENT

I.

THE COURT'S STANDARD OF REVIEW UNDER §6015(f)- WHETHER RESPONDENT ABUSED HIS DISCRETION - SHOULD BE BASED ON WHAT RESPONDENT KNEW, OR COULD HAVE KNOWN, AT THE TIME RELIEF WAS DENIED.

In order not to be an abuse, an exercise of discretion must be legally sound and there must be an honest attempt to do what is right and equitable under the law and the circumstances without the dictates of whim or caprice. *Black's Law Dictionary*. This court has held that whether an abuse of discretion has occurred is a question of fact, and the heavy burden to prove the abuse of discretion is on the taxpayer who must show clearly that the Commissioner's actions were "arbitrary, capricious or without sound basis in fact." (Citations omitted.) *Pacific First Federal Savings Bank v. Commissioner*, 101 T.C. 117 (1993), 121. This court has stated further "[w]here a taxpayer carries [such a] heavy burden of proving abuse of discretion, a broader scope of inquiry is allowed than in the usual case...[citation omitted]...Accordingly, [the court] may examine the process by which [a] decision [is] made...." *Pacific First Federal Savings Bank v. Commissioner, supra* at 121-122. The court should confine its review to the same time frame during which the Commissioner's challenged determination was made, but not to what Respondent represents is the "administrative record." To do otherwise, is unnecessarily prejudicial to taxpayers.

Respondent's position: that this court must confine its review of the Commissioner's determination to deny relief to

Petitioner to what Respondent says is the administrative record in this case is not sustainable. Confining the court to a review of those matters which Service personnel subjectively chose to accumulate in the so-called administrative record, forecloses review of any information outside of that accumulation which Service personnel may have chosen to disregard, perhaps because it did not support the conclusion reached, or because there was a lack of appreciation for the significance and applicability of the information when it was received. Respondent's position presupposes : first, that the administrative record is complete; second, that the administrative record fully and accurately reflects the exchange of information between Service personnel and the taxpayer at the time a decision was being made; third, that any omissions or deficiencies in the existing administrative record are solely the fault of the taxpayer; and fourth, that the taxpayer understood what the Respondent considered relevant to its decision-making. Respondent's position also presupposes that everything which was made available to Respondent's personnel, or which Respondent's personnel should have known from other information in the system, has found its way into the so-called "administrative record" of the taxpayer seeking relief under the statute.

Respondent's presuppositions are of particular note in this case because Petitioner's husband, Mr. Unreliable, submitted two offers in compromise at about the same time as Petitioner's administrative request for relief was filed, thereby assuring that there is some form of separate "administrative record" with

respect to Mr. Unreliable. Whether Mr. Unreliable's "administrative record" contains information relevant to Petitioner's request for relief under section 6015 is unknown because Respondent chose not to produce any portion of that file at trial. However, there is at least one document, the Installment Agreement Request (Exhibit 8-P), which Petitioner and her husband testified they both believed was filed along with the 1995 tax return which conceivably found its way into Mr. Unreliable's offer in compromise administrative file, rather than into Petitioner's administrative file.

A further reason for this court not to confine its review to the content of Respondent's "administrative record," even on certification and irrespective of relevance or hearsay, is that Respondent is then unconstrained in interpreting his own record as he chooses without the benefit to Petitioner of extracting clarifying or mitigating evidence through testimony from a custodian of the record. In this case, Respondent says that Exhibit 10-R is what Area Counsel received when he requested Petitioner's file, that its proffer as evidence is meant only to reflect the administrative file as developed by the appeals officer and the Internal Revenue Service, and that the content of the file is not being "offered for the truth of anything." Trans. p. 182, ls. 2-19. This court should not accept the wholesale submission into the record of 150 pages of unexplained material for any purpose other than the adequacy, or lack thereof, of Respondent's decision making procedures in this case.

Respondent's reliance on *Camp v. Pitts*, 411 U.S. 138 (1973)is misplaced. *Camp*, on the very narrow question raised in that case, holds that *de novo* review is not the proper procedure when a reviewing court finds an agency's informal action is not documented sufficiently to permit judicial review using an abuse of discretion standard. The Supreme Court says that in applying the standard "the focal point for judicial review should be the administrative record already in existence...." *Camp v. Pitts*, 411 U.S. at 142. The Supreme Court does not say that the administrative record is the "sole" source of evidence, and in fact suggests, in appropriate circumstances, an inadequately explained decision may be supplemented. However, in this case as in *Camp*, there is "a contemporaneous explanation of the agency decision" from which this court may conclude the propriety of Respondent's determination to deny relief to Petitioner. *Camp v. Pitts*, 411 U.S. at 143.

Respondent's apparent reliance on recent decisions involving collection due process proceedings to argue that the court is confined to the administrative record is equally misplaced, if not a misunderstanding of the principals involved. See *Magana v. Commissioner*, 118 T.C. 488 (2002), a summary judgment determination, wherein the court concluded as a general, but not mandatory rule, that it could not reach a conclusion regarding an abuse of discretion if it considers arguments not raised by the taxpayer "or not otherwise brought to the attention of" Respondent. It is far too broad a statement to say that in all cases where abuse of discretion is the standard of review that

the court must confine its review to what Respondent presents as the administrative record for the case.

It is not Petitioner's position that Respondent's administrative files should be ignored. It is Petitioner's position that in this case, Respondent's subjectively compiled administrative record cannot stand alone as the sole source of uncontroverted evidence for this court's analysis of Respondent's conduct because it is incomplete and unreliable. In any case, it will be consistent with prior rulings for this court to broaden the scope of its inquiry beyond the administrative record proffered in this case to determine whether the Commissioner's decision was "against logic and effect of the facts presented" or "against the reasonable and probable deductions to be drawn from the facts available at the time the informal decision was made." *Black's Law Dictionary*.

The Notice of Determination sent to Petitioner in this case states the reasons for denial of relief as: "Knowledge of the liability and you are still married and living with [your husband]." The first reason given is a misapplication of criteria for relief under §6015(f) contained in Respondent's published guidance. The second reason is factually true, but is notable for its singularity and the apparent discounting of all other facts and circumstances known or ascertainable about Petitioner in this case. From the Notice of Determination alone, it is impossible to ascertain what Respondent's personnel weighed and did not weigh in making their decisions to deny relief.

II.

RESPONDENT'S DECISION TO DENY EITHER FULL OR PARTIAL RELIEF TO PETITIONER UNDER IRC §6015(f) WAS ARBITRARY AND WITHOUT A SOUND FACTUAL BASIS.

1. THE STATUTE AND ITS LEGISLATIVE HISTORY SHOW CONGRESS EXPECTED THE IRS TO GRANT FULL OR PARTIAL RELIEF UNDER §6015(f) WHEN A REQUESTING SPOUSE DEMONSTRATES A LACK OF ACTUAL OR CONSTRUCTIVE KNOWLEDGE THAT THE LIABILITY WOULD NOT BE PAID.

Section 6015(f) provides as follows:

> "Equitable Relief.--Under procedures prescribed by the Secretary, if–
>
> (1) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any **unpaid tax** or any deficiency (**or any portion of either**); and
>
> (2) relief is not available to such individual under subsection (b) or (c), the Secretary may relieve such individual of such liability."

(Emphasis added.)

A look at the legislative history surrounding the enactment of what became subsection (f) of section 6015 may be instructive. In drafting its version of section 6015, the Senate Finance Committee crafted the language of what ultimately became subsection (c). The intent of the subsection was to make an election "available to limit the liability of spouses for tax attributable to items of which they had no knowledge." Senate Report, IRS Restructuring and Reform Act of 1998, P.L. 105-206 (7/22/98)(Reasons for Change). The Senate version of the statute modified "the innocent spouse provisions to permit a spouse to elect to limit his or her liability for unpaid taxes on a joint return to the spouse's separate liability amount." Id.,

(Explanation of Provisions). In the Senate version, the spouse requesting relief from tax reported on a return, but remaining unpaid, would only be liable for the tax attributable to that spouse's net taxable income. While the specific language referencing an unpaid tax in the Senate version of subsection (c) did not survive the Conference Committee, a compromise in the form of subsection (f) was inserted into the statute, with the conferees making it known that they intended "the Secretary will consider using the grant of authority to provide equitable relief in appropriate situations to avoid the inequitable treatment of spouses in such situations. For example, the conferees intend that equitable relief to be available to a spouse that does not know, and had no reason to know, that funds intended for payment of the tax were instead taken by the other spouse for such other spouse's benefit." Conference Committee Report, Conference Agreement, IRS Restructuring and Reform Act of 1998, P.L. 105-206 (7/22/98). The expectation recited in the Conference Committee Report is precise and clear: full or partial relief should be given when funds intended for the tax payment are expropriated by the other spouse for his or her own use. It is not unreasonable to conclude that Congress intended the principals embodied in the final version of subsection (c) to be applied to provide relief in underpayment situations.

Petitioner and Mr. Unreliable both testified that when Petitioner signed the return, Mr. Unreliable assured her with words, by showing her an Installment Agreement request form, and by making a partial payment with the return, that he would be

taking care of the remaining liability. Proposed Ultimate Finding ¶1. Both Petitioner and Mr. Unreliable testified that the balance remaining due on the 1995 return was solely attributable to Mr. Unreliable. Proposed Ultimate Finding ¶3. In addition to withholding of $10,982.00, Petitioner paid $1,069.00 with the return, an amount the record shows was more than the tax due if calculated using her items only. Proposed Ultimate Finding ¶2. During the period September 1995 through December, 1996, Mr. Unreliable held an S.E.C. license, worked full-time and contributed his share of the household expenses on request from Petitioner. Proposed Finding ¶25. Nothing in their relationship at the time the return was signed by Petitioner on April 15, 1996 provided any clue to give her reason to doubt Mr. Unreliable's representations that he would be making arrangements to pay the balance of the 1995 liability over time through installment payments. Proposed Ultimate Finding ¶1.

Hindsight is inapplicable to justify the Service's arbitrary conduct in Petitioner's case. We now know that Mr. Unreliable did not disclose to Petitioner until 1998 that he had outstanding pre-marital tax liabilities. Proposed Finding ¶35. We also know now that Mr. Unreliable never advised Petitioner of the severity or scope of the S.E.C. investigation. That only became clear to Petitioner when Mr. Unreliable's license was suspended. Petitioner still has no understanding or knowledge of the details surrounding her husband's license revocation. Proposed Finding ¶36. The time to measure whether Petitioner knew or should have known that the liability remaining on the 1995 return, all of

which is attributable to Mr. Unreliable, would not be paid was on April 15, 1996. See Rev. Proc. 2000-15, Section(4)

On April 15, 1996, Petitioner had been married to Mr. Unreliable for eight months. Proposed Finding ¶2. With the exception of a short period when they maintained a joint account to pay wedding expenses, Petitioner never co-mingled her earnings with Mr. Unreliable. Proposed Finding ¶5. Nor did she know how much he earned as a broker-dealer. Proposed Finding ¶6. Whenever she requested reimbursement for household expenses during this eight month period, Mr. Unreliable paid her the amount she told him he owed. Proposed Finding ¶24. The 1995 tax return reflects gross earnings for Mr. Unreliable of $50,565.00. Petitioner's W-2 wages were $57,373.00. Exhibit 1; Proposed Finding ¶11. Petitioner testified that household expenses, exclusive of food and her personal and work-related expenses, during the period September, 1995 through the year 1996 averaged $2,800 per month. Proposed Finding ¶28. Mr. Unreliable's income was sufficient to contribute his one-half to the couple's joint expenses during that period. Proposed Finding ¶11. Not only was Petitioner upset when she saw the tax due on the joint 1995 return, she demanded to know what Mr. Unreliable was going to do about it if she filed jointly with him showing a balance due. Proposed Finding ¶'s 14, 15, 16. While we now know that Mr. Unreliable misrepresented to Petitioner that he was making arrangements to make payments on the 1995 liability[1], when Petitioner signed the

1. Petitioner believes that Mr. Unreliable filed the Installment Payment Request form with the return, and that the document was placed in whatever administrative file the IRS has created for Mr. Unreliable. The evidence

tax return, she had no knowledge, actual or constructive, which suggested the balance remaining on the 1995 liability was not going to be paid by Mr. Unreliable. Proposed Ultimate Finding ¶1.

2. IRS PERSONNEL FAILED TO FOLLOW RESPONDENT'S OWN PUBLISHED GUIDANCE WHEN DETERMINING PETITIONER'S ENTITLEMENT TO RELIEF.

On December 7, 1998, Notice 98-61, 1998-2 C.B. 756, was issued by the Commissioner to provide interim guidance for granting relief pursuant to section 6015(f). The notice was still in effect when petitioner submitted her administrative request for relief and was relied upon by examination personnel when recommending relief be denied. Notice 98-61 was superseded by Rev. Proc. 2000-15, 2000-1 C.B. 447, effective Jan. 18, 2000. Revenue Procedure 2000-15 was in effect when Appeals made its determination to deny relief to Petitioner.

Section 3.02 of Notice 98-61 reads in relevant part:

> "Circumstances under which equitable relief will ordinarily be granted...
>
> (3) At the time the return was filed, the individual did not know, and had no reason to know, that the tax would not be paid. The individual must establish that it was reasonable...to believe that the nonrequesting spouse would pay the reported liability. If an individual would otherwise qualify for relief...except for the fact that the individual did not know, and had no reason to know, of only a portion of the unpaid liability, then the individual will be granted relief to the extent that the liability is attributable to such portion...."

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received at trial only shows that no payments were made by Mr. Unreliable which actually were credited by the IRS to the 1995 liability.

Rev. Proc. 2000-15 maintains this language with one notable change and some minor wording revisions. The notable change is that the knowledge element is determined at the time the return is *signed*, not at the time it is *filed*. If seven threshold criteria contained in both the notice and the revenue procedure are met, a requesting spouse may be relieved of "**all or part** of the liability under §6015(f)...,if taking into account **all the facts and circumstances**, the Service determines that it would be inequitable to hold the requesting spouse liable for such liability." (Emphasis added.) Rev. Proc. 2000-15, Section 4.

Respondent's Notice of Determination sent to Petitioner on October 31, 2000, stated that Petitioner was not entitled to relief under §6015(b), (c) or (f) because: "You had knowledge of the liability, and you are still married and living with the nonrequesting spouse." Exhibit 6-J. This explanation is all that was provided to Petitioner. The reasons stated may be fatal for relief under subsection (c) of the statute but they are insufficient to justify Respondent's determination to deny equitable relief. Of course, Petitioner knew there was a liability showing on the tax return when she signed it. The presence of an unpaid liability on a filed return is precisely the scenario envisioned by Congress for granting equitable relief, and the Commissioner iterates this principal in both his interim and final guidance. If merely signing a joint return showing a liability due "is sufficient to establish actual or constructive knowledge of an underpayment, then no taxpayer signing such a joint return would ever lack knowledge or reason

to know of the underpayment." *Wiest V. Commissioner*, T.C. Memo. 2003-91(March 27, 2003), footnote 7.

There is no way to ascertain from Respondent's Notice of Determination what other criteria, or whether other criteria, were considered and weighed in denying relief. The notice and revenue procedure are littered with references that make it clear that they are promulgated as guidance only and that a weighing of equities is to occur when considering an application for relief under section 6015(f): "Partial list of positive and negative factors", "no single factor will be determinative", "all factors must be considered and weighed appropriately", "the list is not intended to be exhaustive." Rev. Proc. 2000-15, Section (4), *Passim*. Further, the published guidance mirrors the statute by providing for relief from all or part of a tax liability under section 6015(f).

Respondent has offered Exhibit 10-R as his "evidence", not for the truth of anything contained therein but only to reflect the administrative file as it was developed by the appeals officer and the Internal Revenue Service. While Petitioner has addressed the flaws inherent in accepting Respondent's "administrative file" as the sole source of consideration for whether an abuse of discretion has occurred elsewhere in this brief, Petitioner now wishes to hoist Respondent from his own petard.

The Appeals case memo at pp. 31 & 32 of Exhibit 10-R states that relief is being denied because "there would be no hardship,

there is no marital abuse, and no spousal legal obligation. She had knowledge when the joint return was filed that there was a deficiency or understatement (sic) due to lack of estimated payments." Without conceded the truth of the foregoing, it seems clear that the appeals officer arbitrarily selected the criteria from the revenue procedure which the appeals officer perceived Petitioner did not meet and then applied an erroneous factor - knowledge of a deficiency or understatement- to deny relief. Appeals' Case Activity Records at p. 13 of 10-R shows an entry dated 11/18/99 at which **three hours** are recorded for a conference with representative. A second entry dated 9/21/2000 reflects **two hours** being spent meeting with the representative "using all new innocent spouse rules." Surely **five hours** of meeting time resulted in more information being exchanged than is reflected in the appeals officer's notes, comprising one page for the November meeting and two pages for the September meeting. Exhibit 10-R, pp. 105-106 and 113. Petitioner does not know what the reference to "new innocent spouse rules" might mean but it certainly cannot be a reference either to Notice 98-61 or to Rev. Proc. 2000-15, otherwise, the Case Memo would not have used knowledge of a deficiency or understatement as a fatal factor vis-a-vis Petitioner's request for relief. The notes taken by the appeals officer during her meeting with Petitioner's representative on September 21, 2000 demonstrate that information was being "heard" by appeals which was not considered before denying relief to Petitioner: "Married to tph 3 mos in 95"; "he told her he paid liab when filed"; "will suffer hardship"; liab is all non

requesting spouse"; "marriage is tenuous"; "no deficiency attributable to her"; "he said he'd pay"; "no benefit"; "tph lied about paying." Exhibit 10-R, pp. 105-106. Despite Appeals request for and receipt of a statement under penalty of perjury from Petitioner that she "possessed a bona fide reasonable belief that my spouse of three months, Richard G. Wiwi, was going to pay his tax obligation for the 1995 tax year" no reference to that document is made in the Case memo or the Notice of Determination. Exhibits 6-J; 9-P; 10-R, p. 112. This information, and much more, was apparently ignored when making the decision to deny relief to Petitioner.

The analysis of the criteria under Notice 98-61 on the IRS work papers displays this same deficiency in weighing factors:

"Requirements of §6015(f) are as follows:

a. Filing Status MFJ Met

b. Requesting Spouse ineligible under §6015(b) or (c) Met

c. Form 8857 timely filed Met

d. Balance due on 7/22/98 Met

e. Current Marital Status... Not Met

f. Knowledge Test. **Requesting Spouse signature on the return indicates knowledge of the underpayment**. However, **Requesting Spouse may not have known of Non requesting Spouse lack of estimated payments. Not evaluated**

g. Undue Hardship. **A review of the tax return** does not give rise to an undue hardship to pay liability. Not met

h. Liability attributable to Non Requesting Spouse Met

...Conclusions:

...If it was the intent of requesting Spouse to not be responsible for Non Requesting Spouse tax liabilities, Requesting Spouse **should have filed** MFS and reported income on separate returns. As it was, they were

> married during the last four months of the year and there were (sic) 8 months...to make a decision to file together or separately...
>
> **Requesting Spouse should have reasonably known about the underpayment when she signed the tax return. The deficiency is clearly stated above the signature elements.** Requesting Spouse should have inquired prior to signing the tax return. A reasonable person would have inquired....”

(Emphasis added.) Exhibit 10-R, p. 133-134.

This analysis is so far off the mark from the issued guidance that it cannot be deemed a proper exercise of discretion in any manner. Further, the IRS report goes on to say:

> “[T]he review of the tax returns for 1996 and 1997 indicate that **Non Requesting Spouse does not have sufficient income to live on.**...It would then appear that both Requesting Spouse and Non Requesting Spouse are in fact **living on the income from Requesting Spouse** and that Requesting Spouse is in fact providing some degree of support for Non-requesting Spouse.”

(Emphasis added.) Exhibit 10-R, p. 135.

The hardship “analysis” in the IRS work papers appears to be based solely on income information from the couple’s tax returns for 1996 and 1997. Despite the acknowledgment of information available to it that Mr. Unreliable could not possibly be supporting himself, no additional information was recorded about actual living expenses, about Petitioner’s temporary work situation, or about Mr. Unreliable’s medical situation which would determine whether Petitioner could **in fact** have paid the liability in full in 1999 and still been able to meet basic living expenses for herself and Mr. Unreliable. In fact, Appeals had additional information regarding the couples’ financial circumstances available to it because the appeals officer was aware, although the file does not disclose to what degree, that

Mr. Unreliable had submitted an offer in compromise to settle the 1995 liability as to himself because he could not afford to pay it.

After this case was transmitted to Appeals, there is no reflection in Exhibit 10-R to suggest that the appeals officer, despite **five hours** of meetings with representatives of Petitioner, did her own independent analysis, or considered the additional facts given her during those meetings, before denying relief. The amazing similarity in language between the examination report and the appeals case memo regarding Petitioner's "actual knowledge" of the deficiency or understatement shown on the return being the most significant negative factor in denying relief supports this conclusion.

The Commissioner's denial of relief for the grounds stated in the Notice of Determination was arbitrary, capricious and without sound basis in the facts as known or available to the Commissioner at the time Service personnel were deciding to deny relief to Petitioner. Even as supplemented by the administrative files Respondent chose to produce at trial, the Commissioner's denial of relief to Petitioner was arbitrary, capricious and without sound basis in the facts as known, or available, to the Commissioner at the time Service personnel were deciding to deny relief to Petitioner.

3. A DETERMINATION WHETHER TO GRANT OR DENY RELIEF UNDER §6015(f) SHOULD BE BASED ON AN EQUITABLE WEIGHING OF ALL THE FACTS AND CIRCUMSTANCES OF PETITIONER' CASE AT THE SAME POINT THAT RESPONDENT MADE HIS DETERMINATION.

The statutory language is clear- all the facts and circumstances must be taken into account before determining that it is not inequitable to hold a taxpayer liable for any unpaid tax on a filed return. The Commissioner's published guidance has iterated this standard: "No single factor will be determinative of whether equitable relief will or will not be granted in any particular case. Rather all factors will be considered and weighed appropriately. The list is not intended to be exhaustive." Rev. Proc. 2000-15, §4.03, 2000-1 C.B. 447, 448. This court has held as much in its recent cases. "In deciding whether respondent's determination that petitioner is not entitled to relief under section 6015(f) was an abuse of discretion, we will consider evidence relating to all the facts and circumstances. *Ferrarese v. Commissioner*, T.C. Memo 2002-249, 84 Tax Ct. Memo Lexis 259, 266. *See also*, *Wiest v. Commissioner*, T.C. Memo 2003-91 (March 27, 2003).

Even by Respondent's own published guidance, Petitioner is entitled to equitable relief. There is no dispute that the threshold criteria of Rev. Proc. 2000-15 Section 4.01 are met. A requesting spouse who satisfies all the threshold criteria of section 4.01 may be relieved of all or of part of a liability if taking into account all the facts and circumstances it would be inequitable to hold that spouse liable for the liability. Section 4.02 provides specific criteria to be considered when a liability

reported on a jointly filed return is unpaid and states that relief will ordinarily be granted when all three conditions are met:

1. At the time relief is requested, the spouses are no longer married, are legally separated or are living apart. Respondent got this right- Petitioner is still married to and living with Mr. Unreliable.

2. At the time the return was signed, the requesting spouse had no knowledge or reason to know that the tax would not be paid. Respondent got this wrong for all the reasons discussed *supra*.

3. The requesting spouse will suffer economic hardship if relief is not granted. “For purposes of this section, the determination of whether a requesting spouse will suffer economic hardship **will be made** by the Commissioner ...and will be based on rules similar to those provided in §301.6343-1(b)(4)....” Rev. Proc. 2000-15, Section 4.02(c). There is no indication in any part of the record that Respondent considered, beyond tax returns, Petitioner’s economic circumstances using rules similar to those in the regulation, to wit: payment of the entire tax would result in Petitioner being “unable to pay...her reasonable basic living expenses...determination of [which] will vary according to the unique circumstances of [Petitioner]. Reg. §6343-1(b)(4)(i).

In determining what constitutes a reasonable amount for basic living expenses, consideration is to be given to information regarding Petitioner’s age, employment status and

history, ability to earn, number of dependents, amounts reasonably necessary for food, clothing, housing, medical expenses, production of income expenses, and local cost of living. Reg. §6343-1(b)(4)(ii)(A)-(C). It is not possible from the record (however it may ultimately be comprised) to tell what, besides the basic income tax information for 1996 and 1997, was being weighed by Service personnel to determine the existence or absence of hardship but the record does contain a conscious acknowledgment that Petitioner was the primary support for the household during the years Petitioner's administrative request was being processed.

Even if, Petitioner fails to satisfy all three of the criteria from Section 4.02, Section 4.03 of Rev. Proc. 2000-15 provides a "partial list of positive and negative factors" to be taken into account, with no single factor being determinative, for purposes of granting or denying relief. The negative factors are in most cases nothing more than the flip side of the positive factors. Of the factors contained in Section 4.03, Petitioner clearly does not meet (1)(a) Marital Status, (1)(c) Abuse, (1)(e) Nonrequesting spouse's legal obligation. However, even Respondent must concede that the balance due on the 1995 return is attributable to Mr. Unreliable ((1)(f)), that Petitioner did not significantly benefit from the unpaid liability ((2)(c)), and that Petitioner is not out of compliance with federal income tax laws ((2)(e). Further, Respondent failed to properly apply the knowledge or reason to know factors ((1)(d) and (2)(b) of section

4.03. Had Respondent's personnel used the information available to them, Petitioner would satisfy factor (1)(d) as she did not know or have reason to know at the time she signed the 1995 return that the liability would not be paid by Mr. Unreliable. See discussion *supra*. Respondent also failed to properly or fully make a determination regarding economic hardship using the criteria stated in the revenue procedure. Petitioner worked **two** temporary jobs for a substantial portion of 1997 through 1999 to support herself and Mr. Unreliable, and to provide their basic living necessities. Mr. Unreliable did not own a car until Petitioner gave him hers so she could buy one to use in commuting between the two jobs. Petitioner had no benefits in her temporary job and had to pay health insurance premiums from her own wages. Proposed Findings ¶24. From 1997 forward, Petitioner "gave up" on getting reimbursement from Mr. Unreliable and paid nearly all of the household expenses, an amount she estimated to be about $2,800.00 per month, in addition to paying for her own commute expenses, clothing and professional license fees. Proposed Findings ¶28. In 1997, she paid the entire liability shown on the income tax return even though some portion of it was clearly attributable to Mr. Unreliable's earnings and self-employment taxes. Mr. Unreliable submitted an offer in compromise for the 1995 tax liability based on doubt as to collectibility because he could not pay it. Proposed Findings ¶31. When she discovered in 1998 that Mr. Unreliable had mislead her regarding payment of the 1995 tax liability, she did not have sufficient funds in her bank account with which to pay the liability. Proposed Findings ¶24.

Merely reciting how much gross income Petitioner’s W-2 reflected for each of the years 1997 through 1999 presents a myopic and incomplete picture of the couple’s financial circumstances, and the economic hardship which could have resulted were Petitioner forced to pay the outstanding liability at that time.

However, even if this court concludes that it would not have been an economic hardship in 1999 for Petitioner to pay the balance due for 1995, that single factor should not be fatal to granting relief to Petitioner under all the rest of the facts and circumstances of her case. Petitioner was misled into believing that Mr. Unreliable would pay the balance of the liability showing on the 1995 joint return. She paid an amount with the return which more than satisfied any liability attributable to her wages. She has not failed to pay her income tax liabilities when due for any year before or any year after 1995. She worked two jobs for three years to support the household. Equity calls for Petitioner to be relieved at least of the unpaid balance due for the 1995 tax year. In fact, this court may wish to conclude under the facts of this case, that Petitioner is entitled to a refund (to the extent permitted by other statutes) of the amounts she previously paid which exceed her tax liability on the 1995 return.

CONCLUSION

In denying relief to Petitioner in this case, it was necessary for Respondent to ignore, or otherwise misapply, the statutory language, his own regulations, the legislative history, and his own published guidance - conduct which this court should find rises to the level of arbitrary, capricious and without sound basis in the facts as they were known to Respondent at the time relief was being denied. Further an analysis of all the facts and circumstances in

Petitioner's case as known by, or available to, Respondent at the time of the unfavorable Notice of Determination, results in the conclusion that Petitioner is entitled to be relieved of the 1995 income tax liability to the extent her payments have exceeded the tax attributable to her separate items.

Respectfully submitted,

Dated: May 28, 2003

_____
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